IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 06.02.2006

Coram :

THE HONOURABLE MR.JUSTICE P.D.DINAKARAN

AND

THE HONOURABLE MR.JUSTICE P.P.S.JANARTHANA RAJA

Tax Case (Appeal) Nos.427 to 434 of 2000
(Appeal Nos.131 to 138/2000)

The Commissioner of Income Tax ,
Tamil Nadu-II, Madras. ..Appellant in all appeals.

Vs

M/s.Computer Graphics Ltd.,
46, T.T.K. Road,
Chennai-600 018. ..Respondent in all appeals.

Appeals under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal, Madras, 'C' Bench in I.T.A. Nos.2829/Mds/92, 2223/Mds/93, 3069/Mds/92 for the assessment year 1989-90 and I.T.A. Nos.2117/Mds/93, 278/Mds/95, 2454/Mds/96, 2455/Mds/96, 867/Mds/98 dated 28.5.1999 for the assessment years 1990-91, 1991-92, 1992-93, 1993-94 and 1994-95, respectively against the order of the Commissioner of Income tax (Appeals) I, Madras 34 dated 29.11.1994 made in IT Appeal Nos.65/1994-95 and IT Appeal No.53/1992-93 dated 28.8.1992 on the file of the Commissioner of Income Tax (Appeals) VII, Madras 34, against the Order of the Deputy Commissioner of Income Tax, Special Range VII, Chennai 34 dated 23.4.1992 made in No.NIL against the Order of the Assistant Commissioner of Income Tax, Central Circle III(3), Madras dated 29.4.1994 made in No.NIL respectively.

For Appellant : Mrs.Pushya Sitaraman

For Respondent : Mr.C.V.Rajan for
M/s.Gladys Daniel

JUDGMENT

(Judgment of the Court was delivered by P.P.S.Janarthana Raja, J.)

The present appeals are filed under Section 260A of the Income Tax Act, 1961 by the Revenue, against the order passed in I.T.A.

WEB COPY

https://hcservices.ecourts.gov.in/hcservices/

Nos.2829/Mds/92, 2223/Mds/93, 3069/Mds/92, 2117/Mds/93, 278/Mds/95, 2454/Mds/96, 2455/Mds/96, 867/Mds/98 by the Income Tax Appellate Tribunal, Madras, 'C' Bench. On 23.08.2001, this Court admitted the appeals and formulated the following substantial questions of law:-

> "1. Whether the Tribunal was right in holding that the assessee was entitled to relief under Section 32AB as the item dealt with by the assessee did not fall under the prohibited entry 10 to XI Schedule Viz. Photographic apparatus and goods.
> 2. Whether, the Tribunal was right in law that the assessee was entitled to relief under Section 80I as there was manufacturing process in making the graphic art film of colour paper in Jumbo rolls into marketable condition by the process of slitting.
> 3. Whether the Tribunal had material and was correct in upholding the claim for higher commission payment to associated concerns at 5% as against 3% commission paid to other customers and hence the disallowance of 2% under Section 40A(2) by the assessing officer was not proper.
> 4. Whether the Tribunal had material to cancel the addition made on account of undisclosed sales of scrap.
> 5. Whether the Tribunal was right in holding that proceedings under Section 154 could not be initiated as the disallowances made were in respect of the claims considered under Section 143(1)(a).
> 6. Whether the cancellation of interest under Section 234B is proper?"

2. The relevant assessment years are 1989-90 to 1994-95.

I) Question No.2:

It is stated by both the counsel that Question Nos.1 and 2 are interconnected and therefore a request has been made by the counsel to deal with Question No.2, first. The counsel brought to our notice that this issue stands covered by a decision of this Court judgment reported in 261 ITR 491 in the case of India Cine Agencies Vs. C.I.T. which held as follows:

> "On the facts of the present case, the assessee by the use of slitting machine slitted the jumbo photographic colour paper into smaller rolls and cut size flats of the desired size. By this activity, no manufacturing process has been done by the assessee. The assessee imported already manufactured colour papers, which has been now reduced in size according to the needs of the assessee's customers. The original goods as well as the size reduced goods by slitting are all one and the same, i.e., they are photographic colour paper. No new commercial commodity emerged out of the activity carried on, on the original goods - jumbo rolls, which could be

WEB COPY

https://hcservices.ecourts.gov.in/hcservices/

considered as a manufacturing activity at the hands of the assessee. The assessee is only trading in photographic colour papers as a wholesaler and slit the already manufactured and produced photographic paper into required sizes to suit the requirement of its customers and in easily marketable sizes. Therefore, the slitting of the bigger roll into marketable smaller rolls or sizes is an integral part of the trading activity of the assessee. In the abovesaid process, neither manufacture nor production is involved nor a new product emerges even though the goods handled by forklift and hoist and slit by computerised slitting machine and which process is required to be done in a dark air conditioned humidity controlled dust proof room.

In view of the above discussion with particular reference to the activity carried on by the assessee, and in the light of the decisions above referred to, we are of the considered view that on the facts and circumstances of this case, the assessee cannot be regarded as being engaged in the business of manufacture or production of an article or thing. The question is answered in favour of the Revenue and against the assessee."

The facts in the instant case are similar. Following the same, the question is answered in favour of the Revenue and against the assessee.

II) Question No.1:

The learned counsel for the Revenue fairly stated that this question has to be answered in favour of the assessee in view of answering the second question against the assessee. In respect of second question, we held that the assessee was not engaged in the manufacture or production of an article or thing and hence, the assessee was also not engaged in the manufacture of item under the prohibited entry 10 to XI Schedule Viz. Photographic apparatus and goods. Hence, the question is answered in favour of the assessee and against the Revenue.

III) Question No.3:

a) It deals with disallowance of a commission under Section 40A(2) of the Act. The appellant company paid the following amounts as sales commission to the concerns in which the Directors are interested.

1) M/s.Nippon Enterprises South - Partnership firm Rs.17,45,510/-
(At 6% for sale of graphic art film)

2) M/s.Graphic King - Partnership firm Rs.13,19,278/-
(At 6% for sale of graphic art film)

WEB COPY

https://hcservices.ecourts.gov.in/hcservices/

3)	M/s.Print Systems and Products - Partnership firm (At 5% for sale of graphic paper)	Rs. 8,22,813/-
4)	Other parties (for both products at 2%)	Rs.15,84,572/-
	Total	Rs.54,72,173/-

b) As can be seen from the above, out of Rs.54,72,173/-, payment of Rs.38.87 lakhs were made to the above first three concerns. The Assessing Officer observed that for other assessee's concerns who rendered similar services to the appellant company, sales commission was provided at 3% only and hence, he disallowed the balance amount of commission payment to the above referred first three concerns. On appeal, the Commissioner of Income Tax (Appeals) agreed with the Assessing Officer and disallowed the claim under Section 40A(2). Aggrieved by that order, the assessee filed an appeal to the Income Tax Appellate Tribunal. The Income Tax Appellate Tribunal allowed the appeal and directed the Assessing Officer to allow the commission fully. We heard the counsel and perused the matter on record. Three directors of the assessee company had major financial interest in the business of the above three firms. It was noticed that the said three firms were existing since 1970, nearly 20 years ago having a network of their own field staff who were well experienced all over India and also had vast technical knowledge in the line of business. Secondly, the assessee company, started importing jumbo rolls of graphic art films and colour paper which were after processing, slitting, packing as per specifications needed by the customer, to be marketed. There were already giants like Hindustan Photo Films, Northern Graphics, India Cine House etc. who were competitors in the field and were all established concerns. Since the company had to face this competition, it was thought wise to engage the above three concerns as agents to exploit their experience, technical knowledge and also having their own field staff who were all well experienced. Consequently, specific agreements had been entered into for agency. As per the agreement terms, the agents were entitled to 6% commission on the listed price related to graphic art films sales and 5% for colour paper. One of the conditions was that the agents should undertake and bear all the marketing expenses and also such expenses including sale depots, outlets, and branches as deemed necessary. The agents were also authorised to appoint sub dealers in the territory with the consent of the assessee company. The agents were responsible for collection of payments in respect of orders executed. Wherever money was not received from the customers to whom the supplies were made on the basis of the orders procured by the agents, then the agents should recover the same from such customers and the assessee company would be entitled to recover such outstanding from the agent. In other words, there being any bad debts which resulted out of the sales canvassed by the agents, the

WEB COPY

https://hcservices.ecourts.gov.in/hcservices/

same would be recoverable from the agent. It is also further brought to our notice that not only the business had gone up for the assessee but also the payment of commission raised by the above three firms did not result in loss of revenue to the Government. What the officer had done was that he had only alleged invoking Section 40A(2) and had totally ignored the merits of the assessee against resulting in increased sale by the assessee, further resulting in increased income in the hands of the assessee. He also further brought to our notice that the potential competitors of the assessee company felt it necessary to market its products through the firm which were established fully and accordingly entered into agreements with the above three firms. The reasonableness of the expenditure for the purpose of business had to be adjudged from the view point of a businessman and not that of the Revenue, even while invoking section 40A(2). The Tribunal had given a finding that the expenditure incurred was reasonable expenses towards its sole selling agency having its own working force and also outlets as agents throughout India, which had undoubtedly resulted in the assessee's gaining business and on a consideration of all the facts it was held that the disallowance made by the Assessing Officer was unjustified. Also, there was no proof of excessive unreasonable payment and hence, no disallowance could be made under Section 40A(2) of the Act. The reasons recorded by the Tribunal are based on material evidence and not require interference.

c) In view of the foregoing conclusions, the question is answered in favour of the assessee and against the Revenue.

IV) Question No.4:

a) It deals with cancellation of the addition made on account of undisclosed sale of scrap. The assessee company imports jumbo colour papers, graphic art films, medical x-rays and imaging films from M/s.Konica Corporation, Japan and slits the same for the required size in their factory at Ambattur. This process resulted in wastages of the various items as detailed below:

Colour paper 0.4%
Graphic Art film 3.8%
Medical X-ray 3.8%

b) These wastes were sold as scraps. This scarp comprises of edge waste and full coat from X ray films and similarly edge waste and full cost from graphic art film and also from colour paper. The edge waste referred to the cuttings of the edge of the jumbo rolls and full coat referred to the middle portion of the jumbo roll. The edge waste contained very low film coating and hence contained very less silver content compared to that of full coat which was the middle portion. The process certainly resulted in collection of these wastes as the cuttings were made and rolled and supplied to the customers as per their specifications. The company sold the scrap to one Mr.Tippu Sultan. A search was conducted in the factory and office premises under Section 132 on 5th and 6th November 1992. During the course of search, an unsigned chit was found in the custody of Mr.Gopalakrishnan, General Manager of the factory. In that chit, there were some rates of waste like waste of

WEB COPY

https://hcservices.ecourts.gov.in/hcservices/

graphic art film and X-ray film, which was as under:

Graphic art film - full cost	Rs.110/- per Kg.
Edge waste	Rs. 70/- per Kg.
Medical X-Ray – full cost	Rs.120/- per Kg.
Edge waste	Rs. 80/- per Kg.

c) Based on this paper, Mr.Gopalakrishnan's statement was recorded. A sworn statement was also obtained from Mr.Tippu Sultan, scrap dealer on 5.2.1993 and on 12.2.1993. Based on the above statements, the Department worked out the quantity of the scrap and also the value thereof for the accounting years 1986-87 to 1992-93, upto the date of search. The quantity was worked out on the basis of the percentage given by Mr.Gopalakrishnan. However, the assessee did not challenge the quantity to mean that there was no dispute as regards the quantity finally assessed between the revenue and the assessee. As regards the rate, the Department relying on the statement of Mr.Gopalakrishnan and the statement of Mr.Tippu Sultan adopted the highest rates disregarding the type of the scrap, i.e. edge waste or full coat. The rates adopted by the Department are as under:

X-ray scrap at Rs.120/- per Kg.
Graphic art film scrap at Rs.110/- per Kg.
Colour paper scrap at Rs.6/- per Kg.

d) Accordingly, the Assessing Officer made an addition of Rs.66,436/- to the returned income against the admitted figure by the assessee in a sum of Rs.25,196/-. Aggrieved, the assessee filed an appeal to the Commissioner (Appeals), who sustained the addition in a sum of Rs.41,238/- Aggrieved by the order, the assessee filed an appeal to the Income Tax Appellate Tribunal. The Income Tax Appellate Tribunal allowed the appeal.

e) We find that the scrap sales made by the assessee were supported by invoices and they find a place in the scrap register, which was inspected by the Sales Tax authorities and also there was no unaccounted cash by way of sale of scrap. Whatever amount received by the employee from the scrap dealers outside the accounts could not be treated as the income of the assessee. The assessee had accounted for sale of scrap and admitted the income from such sales and hence, the scrap generated was supported by the production and the scrap register. Hence, there was no room to infer any suppression. The Tribunal had considered all the relevant materials and evidences.

WEB COPY

f) In view of the foregoing conclusions, the question is answered in favour of the assessee, against the Revenue.

V) Question No.5:

a) It deals with order under Section 154 wherein the order under Section 143(1)(a) dated 23.01.1990 had been rectified, for the assessment year 1989-90. The assessee had given two computations along with the return filed on 25.12.1989. The first computation was based on Section 115J of Rs.12,66,760/- and another computation on total income under the

https://hcservices.ecourts.gov.in/hcservices/

provisions of Income Tax Act, 1961 was made declaring an income of Rs.11,54,211/- The Assessing Officer processed the return under Section 143(1)(a) on 23.1.1990 accepting the returned income and adopting the income under Section 115J which was higher as per the above details. Subsequently the Assessing Officer had issued notices with letters under Section 154 on 30.07.1990 and 11.11.1991 wherein he had proposed to disallow the following deductions:

Deduction under Section 32AB	Rs.3,54,438/-
Foreign exchange loss	Rs.4,57,998/-
Deduction under Section 80I	Rs.3,84,737/-

b) Consequently interests under Section 234B and 234C were also imposed. The assessee objected to the above rectification. The Assessing Officer had passed an order dated 16.03.1992 and disallowed all the above three items and also levied interest under Section 234B in a sum of Rs.97,657/- and under Section 234C in a sum of Rs.11,614/- respectively. Further he also levied additional tax under Section 143(1A). Aggrieved by the order, the assessee filed an appeal to the Commissioner of Income Tax (Appeals). The Commissioner of Income Tax (Appeals) had stated that since the issues were already covered in the regular order u/s 143(3), he was of the view that the appeal was infructuous and hence dismissed the appeal. Aggrieved, the assessee filed an appeal before the Tribunal. The Tribunal allowed the appeal and held that the action of the Assessing Officer in disallowing the deductions claimed on all issues was clearly a debatable issue and therefore, the order under Section 154 was wrong and bad in law. The learned counsel for the Department supported that the order of the C.I.T. (A) was valid in law. The learned counsel for the assessee, submitted that the items proposed for rectification were not issues which could be the subject matter for rectification under Section 154.

c) We heard the counsel. The legal requirement for making rectification had been listed out in the proviso to Section 143(1)(a) and the items which were rectified as aforesaid were totally beyond the jurisdiction for rectification. The three additions, such as disallowances under Sections 32AB and 80I and foreign exchange fluctuation loss were highly debatable issues and there were two opinions possible, and in such situation, it was not possible to rectify by invoking Section 154. Further it was also brought to our notice the Circular No.689 dated 24.08.1994 reported in 209 ITR 75 statute, which held as follows:

> "The Board desires that no other prima facie disallowance should be made except with the previous approval of the Commissioner of Income Tax, who will, after according approval in suitable cases, bring the same to the notice of the Board"

d) On a careful consideration of all the facts and circumstances of the case and in the light of the discussion above, it is clear that the action of the Assessing Officer in disallowing the deductions claimed on all issues were clearly debatable. The Supreme Court judgment reported in 82 ITR 50 in the case of T.S.Balaram, Income Tax Officer, Company Circle

WEB COPY
https://hcservices.ecourts.gov.in/hcservices/

IV, Bombay Vs. Volkart Brothers and Others, held as follows:

> "A mistake apparent on the record must be an obvious and patent mistake and not something which can be established by a long drawn process of reasoning on points on which thre may be conceivably 2 opinions. A decision on a debatable point of law is not a mistake apparent from the record."

e) Therefore, the rectification order passed under Section 154 was wrong and bad in law. In view of the foregoing conclusions, the question is answered in favour of the assessee and against the Revenue.

VI) Question No.6:

a) This question is directed against deletion of the interest charged under Section 234B of the Act, by the Tribunal. The only argument contended by the learned counsel of the assessee was that, in the assessment order, the officer did not pass order directing to charge interest under Section 234B. It was submitted that the requirement of law is that the officer is supposed to apply his mind and pass order which should be a speaking order. In the assessment order, the Assessing Officer had charged and calculated the interest under Section 234B. The only argument was that the interest was not leviable in the absence of the speaking order. He also relied on the Patna High Court Judgment in the case of Udya Mistanna Bhandar and Complex and 2 others Vs. Commissioner of Income Tax and others reported in 222 ITR 44. In that case, no specific order levying of interest under Sections 234A, 234B and 234C was found in the assessment order, and so it was held that the interest could not be levied through notice of demand.

b) Section 234B is operative with effect from 01.04.1989 and it makes provisions for charging of interest, for non-payment or short payment of advance tax and it is also mandatory in nature. It is only compensatory in nature and has no element of penalty in it. It is sufficient that levying of interest is mentioned in the order of the assessment. It is not necessary that it should be a speaking order. As in this case, the assessment order contained levy of interest under Section 234B of the Act and hence the levy of interest was valid in law.

c) This provision is not appealable because the levy of interest is automatic. Only the Board has given power to reduce or waive the interest. The assessee has to make petition before the Central Board of Direct Taxes or the Chief Commissioner of Income Tax for the purpose of waiver of interest. By virtue of the power vested in the Board, under Section 119(2)(a), the Board has issued a Circular for the purpose of waiver and the said Circular is reported in 225 ITR 101 (St.) As per the Circular, it had empowered that the Chief Commissioner of Income Tax and the Director General of Income Tax can waive or reduce interest charged under Sections 234A, 234B and 234C of the Act. It is for the assessee to make waiver petition before the concerned authority and satisfy the conditions enumerated in the Circular for the waiver of interest under Section 234B of the Act.

WEB COPY

https://hcservices.ecourts.gov.in/hcservices/

d) The counsel for the assessee relied on the judgment of the Patna High Court in the case of Uday Mistanna Bhandar and Complex and 2 others Vs. Commissioner of Income Tax and others, reported in 222 ITR 44, which held as follows, at Page No.50:-

> "From the bare reading of section 156 it is clear that notice of demand claiming interest can be issued only when there is order in the assessment order levying interest. Except in the cases of the assessee Tej Kumari Devi (C.W.J.C. No.2732 of 1995(R) and C.W.J.C. No.2780 of 1995(R)) there is no order in any of the assessment orders levying interest under any of the sections 234A, 234B or 234C. To use the expression "charge interest, if any" or "charge interest as per rules" cannot be read to mean that the Assessing Officer has passed orders "charge interest under all the aforesaid sections". The order to charge interest has to be specific and clear, as for that matter any order to charge any tax, penalty or fine. It is different thing as in the case of Tej Kumari Devi where there is an order levying interest but it left the calculation to the office. The assessee must be made to know that the Assessing Officer after applying his mind has ordered the charging of interest and under which of the sections of the Act. Interest is payable under various provisions like for default or delay in furnishing the return of income [Sections 139(8) and 139(9)] and also under the various sections for default in payment of advance tax (sections 215, 216, 217, 234B and 234C). A notice of demand is somewhat like a decree in a civil suit which must follow the order. When a judgment does not specify any amount to be charged under any particular section, the decree cannot contain any such amount. Similarly when the assessment order is silent if any interest is leviable, the notice of demand under section 156 of the Act cannot go beyond the assessment order and the assessee cannot be served with any such notice demanding interest. We, therefore, do not feel any difficulty in coming to the conclusion that the notices of demand in C.W.J.C. Nos.3609 of 1995 (R), 3287 of 1995(R), 3562 of 1995(R), 3494(R) of 1995 and 3527 of 1995(R), have to be quashed so far these relate to charging of interest under section 234A, 234B or 234C of the Act. We get support for the view which we have taken from the decisions of the Calcutta High Court in Monohar Gidwany v. CIT [1983] 139 ITR 498 and CIT v. Williard India Ltd. [1993] 202 ITR 423 and that of the Gauhati High Court in CIT v. Namdang Tea Co. India Ltd. [1993] 202 ITR 414."

WEB COPY

https://hcservices.ecourts.gov.in/hcservices/

e) From the above judgment, it is clear that there was no specific charge of interest for the assessment order and hence the Patna High Court had taken a view that the levy of interest under Sections 234A, 234B and 234C is not valid in law. A similar view was also taken in the judgment of Patna High Court reported in 217 ITR 72 in the case of Ranchi Club Ltd. Vs. C.I.T. and in the judgment of Delhi High Court reported in 276 ITR 164 in the case of C.I.T. Vs. Gold Tex Furnishing Industries. The above two decisions of the Patna High Court have been affirmed by the Supreme Court judgment reported in 247 ITR 209, in the case of C.I.T. Vs. Ranchi Club Ltd. These judgments have no relevance to the facts of the present case. In the present case, there is a specific charge of interest under Section 234B in the assessment order. In view of the above, the Tribunal is wrong in deleting the levy of interest under Section 234B of the Act and hence the question is answered in favour of the Revenue, against the assessee.

3. Thus the questions are answered as follows:

First Question - in favour of assessee.
Second Question - in favour of Revenue.
Third Question - in favour of assessee.
Fourth Question - in favour of assessee.
Fifth Question - in favour of assessee.
Sixth Question - in favour of Revenue.

No costs.

Sd/-
Asst. Registrar.

/true copy/

Sub Asst. Registrar.

km

To
1. The Assistant Registrar,
The Income Tax Appellate Tribunal,
III Floor, Rajaji Bhavan,
Chennai.

2. The Commissioner of Income Tax,
Tamil Nadu II, Madras.

3. The Deputy Commissioner of Income Tax,
Special Range VII, Madras.

4. The Commissioner of Income Tax (Appeal) VII, Madras 34.

WEB COPY

https://hcservices.ecourts.gov.in/hcservices/

5. The Commissioner of Income Tax(Appeals) I,
Madras 34.

6. The Assistant Commissioner of Income Tax,
Central Circle III(3), Madras.

+ 1 CC to Ms.Pushya Sitaraman, Senior Standing Counsel for Income Tax, SR NO 5108

TC (Appeal) Nos.427 to 434 of 2000
06.02.2006

vc(co)
gp/24.3.

WEB COPY

https://hcservices.ecourts.gov.in/hcservices/